No. 95-154

(3)

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1995

IN RE WORLDS OF WONDER SECURITIES LITIGATION

ROSETTA MILLER; WALTER UNTERMEYER; ALAN NISSELSON; TRUDY WHITMAN NISSELSON; PAUL GREENSTEIN; HOWARD H. WESTON, AS TRUSTEE FOR THE FLORIDA MUNICIPAL, INC., RESTATED DEFINED BENEFIT TRUST AND PLAN; and SYLVIA WIND, on behalf of themselves and the certified class of purchasers of the securities of Worlds of Wonder, Inc.,

Petitioners,

v.

ANGELO M. PEZZANI; DONALD D. KINGSBOROUGH; RICHARD B. STEIN; JOHN B. HOWENSTINE; BARRY H. MARGOLIS; DELOITTE & TOUCHE; SMITH BARNEY, HARRIS UPHAM & CO.; JOSEPHINE ABERCROMBIE; and WORLDS OF WONDER SHARES PARTNERSHIP,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

(1) Did the Ninth Circuit properly apply the principles set forth in *Virginia Bankshares v. Sandberg*, 501 U.S. 1083 (1991), to the facts of this case in determining that plaintiffs failed to present sufficient probative evidence of a material misstatement or omission in the Prospectus?

(2) Did the Ninth Circuit properly apply settled summary judgment standards to the facts of this case in granting summary judgment in favor of defendants on the issue of scienter, where plaintiffs presented no direct evidence of scienter and the defendants presented direct evidence that their overall conduct was inconsistent with the speculative inferences urged by plaintiffs?

(3) Did the Ninth Circuit properly apply settled summary judgment precedent in rejecting speculative inferences urged by plaintiffs where the direct evidence rendered such inferences unreasonable?

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Respondents/defendants Donald D. Kingsborough, Angelo M. Pezzani, and Richard B. Stein (the "Officers") file this brief in opposition to the Petition for Writ of Certiorari ("Pet.") filed by Petitioners Rosetta Miller, Walter Untermeyer, Alan Nisselson, Trudy Whitman Nisselson, Paul Greenstein, Howard H. Weston, as trustee for the Florida Municipal, Inc., Restated Defined Benefit Trust and Plan, and Sylvia Wind ("Plaintiffs").

I. STATEMENT OF THE CASE

A. Facts

Worlds of Wonder ("WOW") was founded in March 1985 to manufacture and sell Teddy Ruxpin, an animated story-telling bear. Teddy Ruxpin began shipping in August 1985 and was the nation's best selling toy for that Christmas season. WOW recorded net sales of $93 million in its first full fiscal year ended March 31, 1986. WOW's second major product, Lazer Tag, became the best selling toy in the 1986 Christmas season, while Teddy Ruxpin maintained its popularity, giving WOW two of the best selling toys of the season. For the fiscal year ended March 31, 1987, WOW had net sales of approximately $327 million. (A3).[1]

At the February 1987 New York Toy Fair, WOW introduced its new product lines and extensions of existing products to a favorable reception. Based on the indications of interest and orders from customers following Toy Fair, WOW's sales and marketing departments projected

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[1] References to the appendices bound with Plaintiffs' petition are styled "(A___)."

sales of $700 million to $800 million for fiscal year 1988, beginning April 1, 1987. WOW's fiscal year 1988 financial plan, which was approved by WOW's Board in April 1987, conservatively projected net sales of $542 million. (A25).

In order to finance the expanded product development and manufacturing needed to meet the anticipated demand for the company's products, on June 4, 1987, WOW conducted an $80 million public offering of convertible debentures. The risk disclosure in the Prospectus was so extensive that the two major rating agencies, Moody's and Standard & Poors, rated the debentures as below investment grade, *i.e.*, "junk bonds," meaning that the debentures carried a severe risk of default. The marketplace clearly understood the investment risks, for it demanded a yield on the debentures that reflected the substantial risk entailed by their purchase. The interest rate on the debentures was 50% higher than the prevailing rate for investment grade corporate debentures. (A3-A4).

Although Lazer Tag sales in April-May 1987 had declined from Christmas levels, management believed that this was due to the normal seasonality (the April-June quarter is traditionally the weakest in the toy industry) and to WOW's decision, on the advice of outside consultants, to withdraw Lazer Tag advertising temporarily after a boy playing with Lazer Tag was accidentally shot by a Los Angeles area law enforcement officer in April 1987. WOW planned to resume advertising in the Fall of 1987 and projected strong Lazer Tag sales for all of fiscal 1988. For a variety of reasons, however, WOW's expectations were not met. Disappointing sales for the

1988 Christmas season (beginning in September and October) combined with the substantial expenses incurred in increasing production to meet the expected but unrealized demand, caused severe cash difficulties. WOW filed for bankruptcy on December 21, 1987.

B. Proceedings Below

The District Court granted the motion of the Officers and other defendants for summary judgment. *In re Worlds of Wonder Sec. Litig.*, 814 F. Supp. 850 (N.D. Cal. 1993).[2] The Ninth Circuit affirmed summary judgment for the Officers, directors and underwriters, holding that the

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[2] The Ninth Circuit noted that the district court's grant of summary judgment in 1993 occurred "after a tortured five years of proceedings." (A5 (citing *In re Worlds of Wonder Sec. Litig.*, 694 F. Supp. 1427 (N.D. Cal. 1988) (dismissing Plaintiffs' complaint); *In re Worlds of Wonder Sec. Litig.*, 721 F. Supp. 1140 (N.D. Cal. 1989) (dismissing in part Plaintiffs' amended complaint); *In re Worlds of Wonder Sec. Litig.*, [1989-90 Tr. Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,004 (N.D. Cal. 1990) (certifying Plaintiffs' class); *In re Worlds of Wonder Sec. Litig.*, [1990-91 Tr. Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,689 (N.D. Cal. 1990) (denying shareholders' motion for summary judgment); *In re Worlds of Wonder Sec. Litig.*, [1992 Tr. Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,018 (N.D. Cal. 1992) (granting Plaintiffs' motion to quash); *In re Worlds of Wonder Sec. Litig.*, 147 F.R.D. 208 (N.D. Cal. 1992) (denying Officers' motion to quash Plaintiffs' subpoena to Securities Exchange Commission); *In re Worlds of Wonder Sec. Litig.*, 147 F.R.D. 214 (N.D. Cal. 1992) (denying Plaintiffs' motion to compel Deloitte to produce internal audit manuals))). After the Ninth Circuit panel affirmed the District Court's grant of summary judgment, Plaintiffs petitioned for rehearing and suggested the appropriateness of rehearing *en banc*, which petition also was denied.

debenture Prospectus was not materially misleading as a matter of law.[3] The Ninth Circuit held that the risk disclosure warned investors that the toy industry and WOW's sales were highly seasonal, with the majority of sales occurring in the Christmas season; that WOW would be adversely affected by a seasonal sales shortfall; that internal controls had continually lagged behind WOW's growth; and that WOW's cash position was precarious and that the company would need additional bank credit. The panel also found that Plaintiffs failed to provide probative evidence that the Prospectus contained any material misstatement or omission concerning WOW's existing sales practices, liquidity, or internal controls. (A14-A28).

With respect to the Rule 10b-5 claim, the Ninth Circuit held that the Class had not presented probative evidence of scienter, and that the defendants' overall conduct – including the post-offering expansion of the Company, the disclosure of adverse information, and minimal stock sales – negated an inference of scienter. (A39-A40).

II. SUMMARY OF ARGUMENT

The Petition primarily concerns the Ninth Circuit's holding with respect to the outside auditors, Deloitte &

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[3] The panel affirmed in part and reversed in part as to the outside auditors. The panel affirmed summary judgment for the auditors on the Rule 10b-5 claim, holding that Plaintiffs had not provided sufficient evidence of scienter. The panel reversed summary judgment in favor of the auditors on the Section 11 claim, and remanded those claims for trial.

Touche ("Deloitte"), and the Court's application of summary judgment standards to Plaintiffs' claims against Deloitte. To the extent that the Petition addresses the claims against the Officers, Plaintiffs provide no basis for this Court to grant a writ of certiorari.

Plaintiffs do not challenge the legal principles applied by the Ninth Circuit. Instead, they claim that the Ninth Circuit *misapplied* those principles to the facts of this case, resulting in the wrong holding. Plaintiffs thus urge this Court to review the factual and evidentiary arguments that were thoroughly considered and rejected by the courts below. But Plaintiffs' dissatisfaction with the Ninth Circuit's fact-bound application of settled law, without more, is not an appropriate basis for Supreme Court review. *See Rice v. Sioux City Memorial Park Cemetery, Inc.*, 349 U.S. 70, 79 (1955) (stressing the importance that the Court not grant a writ of certiorari " 'except in cases involving principles the settlement of which is of importance to the public as distinguished from that of the parties, and in cases where there is a real and embarrassing conflict of opinion and authority between the circuit courts of appeal.' ") (quoting *Layne & Bowler Corp. v. Western Well Works, Inc.*, 261 U.S. 387, 393 (1923)); *see also* Sup. Ct. R. 10. Further, Plaintiffs' arguments that the Ninth Circuit misapplied the law and that its resulting holding conflicts with the decisions of this Court and the other Circuit Courts are based solely on mischaracterizations of the factual and legal bases for the Ninth Circuit's decision.

Plaintiffs' factual misstatements permeate their Petition. Plaintiffs make the same evidentiary arguments that were considered and rejected by the Ninth Circuit and

the district court. After reviewing the evidence presented by the Plaintiffs below, the Ninth Circuit determined that the evidence did not support Plaintiffs' factual assertions. The Ninth Circuit held that WOW's difficulties with its internal controls had been adequately disclosed; that there was no "collapse" in sales at the time of the offering; that WOW was not experiencing a "liquidity crisis" at the time of the debenture offering; and that WOW did not fail to disclose material information about its sales practices. The evidence supporting these findings was thoroughly discussed in the Ninth Circuit's opinion. (A14-A28); *see also* Section I(A), *supra*.

Plaintiffs also misstate three separate aspects of the Ninth Circuit's holding: 1) the manner in which the Ninth Circuit reached its determination that the debenture Prospectus contained no materially misleading statements; 2) the Ninth Circuit's holding regarding scienter; and 3) the manner in which the Ninth Circuit applied well-settled summary judgment standards.

Plaintiffs challenge the Ninth Circuit's application (but not adoption) of the "bespeaks caution" doctrine. Plaintiffs assert that the Ninth Circuit held that risk disclosure *per se* "immunizes material misrepresentations or omissions of *existing facts*." Pet. at 25. To the contrary, the Ninth Circuit, after thoroughly reviewing the evidence, held that the Prospectus contained no material misrepresentations or omissions of existing fact. That determination was based on a measured and fact-specific application of settled law in a manner that was wholly consistent with Supreme Court precedent and the decisions of the other Circuits.

Plaintiffs also erroneously state that the Ninth Circuit ignored Plaintiffs' evidence of scienter. Rather, the Ninth Circuit, after reviewing all of the facts, held that Plaintiffs had not presented probative evidence of scienter, and that the evidence presented by defendants negated any inference of scienter.

Finally, Plaintiffs assert that the Ninth Circuit "improperly weigh[ed] and resolv[ed] conflicts in the evidence." Pet. at 29. However, the Ninth Circuit thoroughly considered the evidence in light of controlling standards for summary judgment.

III. ARGUMENT

A. There Is No Need For Supreme Court Review Of The Ninth Circuit's Determination That The Prospectus Contained No Material Misrepresentations Or Omissions.

1. The Ninth Circuit Concluded that the Prospectus Contained No Material Misrepresentations or Omissions Based on a Review of the Evidence.

The Ninth Circuit conducted a *"de novo"* review of the evidence and affirmed the district court's determination that the " 'textual part' of the Debenture Prospectus was not materially false and misleading." (A6-A7). In conducting that review, the Ninth Circuit was mindful that materiality is a "fact-specific issue which should ordinarily be left to the trier of fact," but noted that Plaintiffs can defeat summary judgment "only by showing a genuine issue of fact with regard to a particular statement by the company or its insiders." (A6). Thus the

Ninth Circuit separately analyzed each of the claimed misstatements to determine whether Plaintiffs met that burden. (A7; A14-A28).

In *Virginia Bankshares v. Sandberg*, 501 U.S. 1083 (1991), this Court noted the importance of considering a claimed misstatement in context. There, this Court observed that "publishing accurate facts . . . can render a misleading proposition too unimportant to ground liability." *Id.* at 1097. In analyzing the claimed material misstatements and omissions in the Prospectus at issue here, the Ninth Circuit similarly held " 'that economic projections, estimates of future performance, and similar optimistic statements in a prospectus are not actionable when precise cautionary language elsewhere in the document adequately discloses the risks involved.' " (A7). The Ninth Circuit approved the district court's use of the "rubric of the 'bespeaks caution' doctrine" to describe the above holding (A7), noting that "bespeaks caution" is simply shorthand for the "unremarkable proposition that a statement must be analyzed in context." (A11); *see also In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 371-73 (3d Cir. 1993), *cert. denied*, 114 S. Ct. 1219 (1994); *Rubinstein v. Collins*, 20 F.3d 160, 166-68 (5th Cir. 1994).

Plaintiffs do not challenge the bespeaks caution doctrine, conceding that it is " 'merely new nomenclature rather than [a] substantive change in the law.' " Pet. at 24 (citing *Trump*, 7 F.3d at 364). Rather, plaintiffs assert that the Ninth Circuit erred in 1) determining that risk disclosure *"per se"* precludes liability; and 2) holding that risk disclosure "immunizes" material misstatements of existing fact. Pet. at 24, 26. These assertions mischaracterize the Ninth Circuit's opinion.

The Ninth Circuit did not hold, as Plaintiffs assert, that "the mere fact that the Prospectus *addressed* a particular subject foreclosed any claim that the Prospectus was misleading with respect to that subject." Pet. at 26 (emphasis in original). The Ninth Circuit emphasized the need for "precise cautionary language" that was directly addressed to the allegedly misleading misstatement, and specifically held that "blanket warnings" that the securities were risky would be insufficient to avoid liability. (A12). The Ninth Circuit's thorough analysis of the specificity and accuracy of the risk disclosures in light of the evidence also demonstrates that the panel did not apply a *"per se"* rule. (A14-A28).[4]

Plaintiffs also assert that the Ninth Circuit improperly held that risk disclosure "immunizes material misrepresentations and omissions of *existing facts*." Pet. at 25 (emphasis in original). However, Plaintiffs' interpretation of the *WOW* decision is belied by *WOW* itself and was explicitly rejected by the Ninth Circuit's subsequent decision in *Kaplan v. Rose*, 49 F.3d 1363 (9th Cir. 1994), *petition for cert. filed*, 63 U.S.L.W. 3849 (U.S. May 10, 1995) (No. 94-1895). In *Kaplan*, the Ninth Circuit observed that its recent adoption of the "bespeaks caution" doctrine in *WOW* "holds that if 'precise cautionary language . . . directly addresses itself to future projections, estimates, or forecasts in a prospectus,' 'the projections will not give rise to a claim of securities fraud.' " 49 F.3d

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[4] Plaintiffs' references to the Ninth Circuit's analysis of the Prospectus do not support their assertion that the court applied the bespeaks caution doctrine as a *per se* rule. See Sections III(A)(1)(a)-(b), *infra*, and n.3, *supra*.

at 1373. The court in *Kaplan*, however, concluded that the *WOW* decision did *not* eliminate liability for misrepresentations of existing facts or conditions. *Id.* at 1374; *see also In re Valence Technology Sec. Litig.*, No. C94-1542-SC, 1995 WL 274343 at *14, 16 (N.D. Cal. May 8, 1995) (refusing to apply the bespeaks caution doctrine because plaintiffs' allegations "concern existing misrepresentations"); *Whirlpool Fin. Corp. v. GN Holdings*, 873 F. Supp. 111, 124 n.19 (N.D. Ill. 1995); *In re Browning-Ferris Indus. Sec. Litig.*, 876 F. Supp. 870, 879 (S.D. Tex. 1995).

Further, the Ninth Circuit held that Plaintiffs had not presented sufficient evidence showing that the textual disclosure in the Prospectus materially misrepresented WOW's business and financial condition – not that the risk disclosure somehow "immunized" material misstatements of existing fact. The only two examples cited by Plaintiffs, relating to WOW's sales and internal controls, do not support their arguments to the contrary.[5]

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[5] Plaintiffs' argument also references pages 17-19 of their petition, Pet. at 26, which address the alleged evidence regarding WOW's liquidity and WOW's sales practices. In that earlier discussion, Plaintiffs claim that the Ninth Circuit somehow "ignored" their evidence. Pet. at 18. However, the Ninth Circuit thoroughly addressed the evidence presented by Plaintiffs and determined that Plaintiffs' arguments were not supported by the facts.

The Ninth Circuit held that the Prospectus "clearly bespoke caution on the serious risks WOW's liquidity crisis posed to investors." (A15). Making the identical argument that was rejected below, Plaintiffs assert that the Prospectus did not disclose that WOW would supposedly run out of cash "immediately after" the offering. Pet. at 18. However, Plaintiffs relied on only two documents, both of which are dated after the offering: 1) a memorandum from WOW's lender indicating that

The Ninth Circuit conducted a thorough *de novo* review of all the evidence submitted by Plaintiffs in support of those allegations, and determined that the evidence did not support their claims. (A17-A19; A22-A26). Plaintiffs' argument is thus nothing more than a complaint that the Ninth Circuit got the facts wrong. However, that is not an appropriate basis for review by this Court.

WOW had drawn-down on its line of credit; and 2) a memorandum by Mr. Stein speculating that WOW might encounter a cash shortfall in late 1987. (A15-A16). The Ninth Circuit specifically considered both documents, and determined that the documents did not show that WOW was out of cash at the time of the offering. (*Id.*)

Plaintiffs also challenge the Ninth Circuit's factual findings regarding WOW's sales practices. However, as noted by the Ninth Circuit, Plaintiffs themselves "concede[d] that price protection is a common practice in the toy industry," and "the undisputed evidence also indicates that stock balancing is commonplace in the industry." (A20). Accordingly, WOW had no duty under the securities laws to disclose its observance of those practices. (*Id.*) The court also considered Plaintiffs' evidence of supposed guaranteed sales, and reached the factual determination that such evidence was "speculative, nebulous and nowhere purported to quantify the degree to which WOW engaged in this 'normal business' practice." (A29). The Ninth Circuit noted that WOW's auditors had examined WOW's sales practices and concluded that any guaranteed sales "were minimal in number and did not have a material impact on WOW's financial statements taken as a whole." (*Id.*)

a. Sales and demand

Plaintiffs assert that the Prospectus failed to disclose that sales and demand for WOW's products were "collapsing" at the time of the debenture offering. However, the Ninth Circuit carefully examined the specific risk disclosures in the Prospectus and determined that the fact Plaintiffs claim was omitted – that sales for WOW's products had declined – actually was disclosed. As the Ninth Circuit observed, the Prospectus "fully disclosed" 1) a significant decline in both net sales and net income for the first three months of calendar 1987; 2) that WOW expected that sales for the quarter ended June 30, 1987 would be below sales for the prior three quarters; and 3) that the loss for the quarter would be "disproportionally greater" than the year-earlier quarter. (A22-A23). Thus, the Prospectus clearly and specifically disclosed a downward trend in sales and earnings, and the panel did not, as Plaintiffs assert, provide immunity on the basis that the Prospectus merely "addressed" a subject. Pet. at 26.

More importantly, Plaintiffs' evidence did not support their claim that WOW failed to disclose an existing "collapse" in sales and product demand at the time of the offering. Plaintiffs argued that because WOW's sales (primarily for Lazer Tag) in April and May 1987 were below WOW's internal plan for the fiscal year ended March 31, 1988, the Officers should have disclosed that sales were "dead" at the time of the offering. (A24-A25). However, the evidence considered by the Ninth Circuit showed that WOW's Officers, the investment bankers, and retailers all expected that WOW's products would sell well over the coming fiscal year; that WOW's sales performance in

April and May 1987 was "relatively inconsequential," since WOW's internal financial plan projected that sales for those months would account for only four percent of total anticipated revenue for fiscal year 1988 (most toy sales occur at Christmas); and that WOW had commenced a production schedule implementing the corporation's business plan projecting $542 million in sales. (A25). The Ninth Circuit determined that Plaintiffs' evidence did not support their contention that there was a sales crisis at the time of the offering, and indeed, that such a contention was contradicted by the evidence. (A24-A26). Plaintiffs' disagreement with that factual determination provides no basis for this Court to grant a writ of certiorari.

b. Internal controls

Plaintiffs' argument concerning WOW's disclosure of internal controls, (Pet. at 11-12), is particularly ironic given the panel's finding that, if anything, WOW "erred on the side of over disclosure." (A19). In attacking the decision, Plaintiffs misrepresent the Ninth Circuit's holding and again rely on documents and arguments that were thoroughly examined by the courts below.

First, the Ninth Circuit did *not* hold, as Plaintiffs assert, that omissions regarding existing problems with WOW's internal controls were rendered immaterial by the disclosure of future risks. Pet. at 25. Indeed, the Ninth Circuit expressly noted the Prospectus' disclosure that WOW's internal controls had "lagged behind" the Company's growth, and that there was no assurance that efforts to improve internal controls would be successful.

(A17-A18). Similarly, the court noted that the Prospectus "did not state or imply that WOW's internal control problems 'were in the past' and not ongoing." (A18). Thus the Prospectus *did* disclose internal control deficiencies.

Second, Plaintiffs' evidence regarding internal control deficiencies demonstrated that those deficiencies, to the extent they existed at the time of the offering, were immaterial. Plaintiffs relied entirely on Deloitte's management letter that was prepared 2 1/2 months after the offering. The Ninth Circuit, however, noted that the management letter concluded that WOW's internal controls "had no material weaknesses." (A18).

2. The Ninth Circuit's Determination that the Prospectus Contained no Material Misrepresentations or Omissions is Consistent with Supreme Court Precedent and the Decisions of Other Circuits.

Plaintiffs argue that the Ninth Circuit's determinations regarding materiality and the adequacy of the disclosures in the Prospectus conflict with Supreme Court precedent and the decisions of the other Circuits. However, Plaintiffs' argument is premised on their erroneous contention that the Ninth Circuit held that risk disclosure "*per se*" precludes liability, which it did not. *See* Section III (A), *supra*.

As the Ninth Circuit noted, its context-specific approach to analyzing the alleged misstatements was entirely consistent with *Virginia Bankshares v. Sandberg*, 501 U.S. 1083, 1097 (1991), which held that "while a misleading statement will not always lose its deceptive

edge simply by joinder with others that are true, the true statements may discredit the other one so obviously that the risk of real deception drops to nil." (A12); *see also In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 369, 373 (3d Cir. 1993) ("*Virginia Bankshares* just restates . . . that materiality involves a context-specific analysis such that warnings and cautionary language will sometimes suffice to render the allegedly misleading misrepresentations or omissions immaterial as a matter of law"), *cert. denied*, 114 S. Ct. 1219 (1994). In *Trump*, the Third Circuit noted that its context-specific adoption of the "bespeaks caution" doctrine also was consistent with this Court's decision in *TSC Industries v. Northway, Inc.*, 426 U.S. 438 (1976), and stated that " 'bespeaks caution' is essentially shorthand for the well-established principle that a statement or omission must be considered in context, so that accompanying statements may render it immaterial as a matter of law." *Trump*, 7 F.3d at 364.

Similarly, there is no Circuit split on this issue. The Ninth Circuit noted that its definition of the "bespeaks caution" doctrine was supported by "a wealth of authority" from other Circuits and district courts. (A10). Indeed, the Ninth Circuit closely followed the Third Circuit's decision in *Trump*, which is considered the leading decision on the bespeaks caution doctrine. The Ninth Circuit also cited to cases in the First, Second, Fifth, Sixth, and Eighth Circuits adopting the doctrine. (A9-A10); *see Rubinstein v. Collins*, 20 F.3d 160, 166-68 (5th Cir. 1994); *Moorhead v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 949 F.2d 243, 245-46 (8th Cir. 1991); *Sinay v. Lamson & Sessions Co.*, 948 F.2d 1037, 1040 (6th Cir. 1991); *I. Meyer Pincus & Assoc., P.C. v. Oppenheimer & Co.*, 936 F.2d 759, 763 (2d Cir.

1991); *Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 879 (1st Cir. 1991). Since the Ninth Circuit's decision in *WOW*, the bespeaks caution doctrine also has been adopted by the Eleventh Circuit in *Saltzberg v. TM Sterling/Austin Assocs.*, 45 F.3d 399 (11th Cir. 1995).

None of the courts citing the Ninth Circuit's adoption of the "bespeaks caution" doctrine in *WOW* has held that *WOW*'s approach to the "bespeaks caution" doctrine was inconsistent in any material manner from decisions of the other Circuits. *See Kaplan v. Rose*, 49 F.3d 1363, 1373 (9th Cir. 1994); *In re Valence Technology Sec. Litig.*, 1995 WL 274343 at *14, 16; *Whirlpool Financial*, 873 F. Supp. at 124 n.19; *Browning-Ferris*, 876 F. Supp. at 879, 882.

The cases cited by Plaintiffs are not to the contrary. Plaintiffs' suggestion that the Ninth Circuit's decision is inconsistent with *Rubinstein* again is based on their erroneous contention that the Ninth Circuit held that risk disclosure *"per se"* immunizes misstatements or omissions. The Fifth Circuit in *Rubinstein* did not reject a context-specific approach to analyzing risk disclosure, but held only that the district court erred in applying a *per se* rule that economic forecasts and predictions may *never* form the basis for securities fraud when couched in cautionary language. 20 F.3d at 167. The Fifth Circuit did not reject more fact-specific applications of the bespeaks caution doctrine, such as that applied by the Ninth Circuit. *Id.* Indeed, the Ninth Circuit cited *Rubinstein* as providing an explanation of the doctrine. (A10-A11).

Similarly, in *Mayer v. Mylod*, 988 F.2d 635, 639 (6th Cir. 1993), which was decided on a motion to dismiss, the Sixth Circuit held only that risk disclosure does not *per se*

cure the misleading nature of alleged misstatements. In *Mayer*, the Sixth Circuit clarified and narrowed its earlier decision in *Sinay v. Lamson & Sessions Co.*, which the *Mayer* court feared could have been interpreted as holding that economic projections coupled with cautionary statements were *per se* non-actionable. *Mayer* held, at the pleading stage, that it was necessary to "weigh" the evidence against the risk disclosure. In *WOW*, however, the Ninth Circuit, after extensive discovery, held that the disclosure in the Prospectus was not misleading in light of all the evidence. *WOW* is entirely consistent with *Mayer*, given that the Ninth Circuit, like the Sixth Circuit, refused to establish a sweeping rule that cautionary statements will always render misrepresentations or omissions immaterial as a matter of law. *See also Trump*, 7 F.3d at 373 n.16 (discussing *Mayer*).

Pommer v. Medtest Corp., 961 F.2d 620 (7th Cir. 1992), is similarly inapplicable. *Pommer* held merely that "boilerplate" and "generic" warnings that did not address the subject matter of the alleged false statements would be insufficient to avoid liability. *Id.* at 624-25. The Ninth Circuit similarly noted that "blanket warnings" are insufficient, citing *Kline v. First Western Government Securities*, 24 F.3d 480, 489 (3d Cir.) ("application of the 'bespeaks caution' doctrine . . . requires that the language bespeaking caution relate directly to that by which plaintiffs claim to have been misled"), *cert. denied*, 115 S. Ct. 613 (1994). (A12).

Plaintiffs' argument that the Ninth Circuit's decision is inconsistent with the decisions of this Court and the other Circuits is clearly wrong. That argument is based solely on Plaintiffs' misstatement of the bases for the

Ninth Circuit's opinion, a misstatement that is readily apparent from the text of the opinion. The Ninth Circuit expressly rejected the application of the bespeaks caution doctrine that Plaintiffs contend it adopted; the Ninth Circuit instead adopted a "context-specific approach," which "applies only to precise cautionary language which directly addresses itself to future projections, estimates or forecasts." This approach is wholly consistent with the decisions of other Circuits.

B. The Ninth Circuit's Holding On Scienter Was Based On The Specific Facts In This Case.

To withstand summary judgment on the issue of scienter, plaintiffs must present sufficient probative evidence of a "mental state embracing an intent to deceive." *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12, *reh'g denied*, 425 U.S. 986 (1976). Thus, in analyzing the WOW defendants' motions for summary judgment on the issue of scienter, the Ninth Circuit looked at the facts presented by Plaintiffs to determine whether they met that evidentiary burden. The Ninth Circuit found that the Plaintiffs failed to present *any* direct evidence of scienter, and that the inferences that they sought based on circumstantial evidence were unreasonable. The Ninth Circuit thus concluded, based on the facts in this case, that Plaintiffs had not made the required evidentiary showing. Plaintiffs' contention that the Ninth Circuit's holding dictates that summary judgment on the issue of scienter be granted

regardless of the strength of the evidence submitted by plaintiffs is erroneous. Pet. at 3, 20.[6]

Plaintiffs make conclusory allegations that the Officers "knowingly made false public statements"; "sold massive quantities of WOW stock"; "failed to disclose material adverse facts known to them"; and "were aware of bogus financial transactions." Pet. at 27. However, those identical allegations were fully considered and rejected by the Ninth Circuit and the district court after a careful review of the evidence. (A38-A39). The Ninth

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[6] Plaintiffs also challenge the Ninth Circuit's holding regarding the auditors' alleged scienter, claiming that the court held that "a § 10(b) plaintiff can *never* get to the jury on the *scienter* issue, no matter how strong his evidence of fraudulent intent, knowledge or recklessness, as long as the auditor proffers expert testimony that its accounting determinations were valid." Pet. at 3. However, the court held nothing of the kind. The court held that Plaintiffs had presented no probative evidence of fraudulent intent or recklessness, not that such evidence was outweighed by the opinion of the auditor's expert. Indeed, the court barely mentioned the declaration of the auditor's expert, focusing instead on the *absence* of any evidence presented by Plaintiffs. In so holding, the court fully considered all of the evidence presented by Plaintiffs, carefully reviewed the declaration of Plaintiffs' expert, accepted as true the existence of disputed issues as to whether WOW's audited financial statements failed to comply with generally accepted accounting principles, and correctly held that merely questioning accounting judgments was not sufficient to establish scienter. (A42-A44); *see also In re Software Toolworks Sec. Litig.*, 50 F.3d 615, 627 (9th Cir. 1994), *petition for cert. filed*, 63 U.S.L.W. 3892 (U.S. June 12, 1995) (No. 94-2027); *Melder v. Morris*, 27 F.3d 1097, 1103 (5th Cir. 1994); *Malone v. Microdyne Corp.*, 26 F.3d 471, 479 (4th Cir. 1994); *Stamatio v. Hurco Cos., Inc.*, No. IP 94308C, 1995 WL 431916, at *2 (S.D. Ind. July 18, 1995); *In re In-Store Advertising Sec. Litig.*, 878 F. Supp. 645, 648-49 (S.D.N.Y. 1995).

Circuit's fact-based application of settled law is not an appropriate issue for Supreme Court review.

Plaintiffs also assert that the Ninth Circuit erroneously held that "persons [such as officers, directors, underwriters and controlling persons] can 'conclusively' rebut *scienter*" merely by submitting certain evidence. Pet. at 4, 37. First, regardless of whether there was evidence "rebutting" scienter (which there was), defendants are not required to prove the absence of scienter; rather plaintiffs must present sufficient probative evidence of scienter. *See Matsushita Elec. Indus. Co. v. Zenith Radio, Corp.*, 475 U.S. 574, 587, 596-97 (1986). Here, the Ninth Circuit held that Plaintiffs "produced no direct evidence of any scienter." (A39). To the extent Plaintiffs contend that the Ninth Circuit's holding applies to cases in which plaintiffs actually meet their evidentiary burden with regard to scienter, they are wrong. The Ninth Circuit was not presented with such a case, and its opinion does not address that hypothetical situation.

Plaintiffs also argue that the Ninth Circuit's holding in this case conflicts with the holdings of other Circuits. However, that argument hinges on Plaintiffs' obviously erroneous (and unsupported) assertion that the Ninth Circuit held that "a corporate insider can trade with impunity as long as he retains most of his stock." Pet. at 27. Here, Plaintiffs presented no evidence of insider trading. Instead, Plaintiffs attempted to infer scienter for all of the Officers based on Mr. Kingsborough's sale of a fraction of his stockholding in late July 1987. The Ninth Circuit rejected such an inference, because 1) Mr. Kingsborough's sales occurred *after* the disclosure of disappointing results for the June 30, 1987 quarter and well

before WOW's problems in late 1987; 2) the other Officers, Messrs. Pezzani and Stein, sold *no* stock prior to WOW's collapse; and 3) Mr. Kingsborough retained the vast bulk of his stockholdings. The Ninth Circuit properly held that this evidence negated the "inference of scienter" urged by Plaintiffs on the basis of Mr. Kingsborough's sales. (A40 (citing *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1117 (9th Cir. 1989), *cert. denied*, 496 U.S. 943 (1990) ("credible and wholly innocent explanations for the stock sales . . . are sufficient to defeat any inference of bad faith"))). *Accord Acito v. IMCERA Group*, 47 F.3d 47, 54 (2d Cir. 1995); *Thornton v. Micrografx*, 878 F. Supp. 931, 938 (N.D. Tex. 1995).

Plaintiffs similarly mischaracterize the Ninth Circuit's holding regarding the other evidence negating any inference of scienter, which included the Officers' post-offering efforts to continue WOW's expansion and the detailed risk disclosure in the Prospectus. Contrary to Plaintiffs' arguments, the Ninth Circuit did not hold that this evidence provided an absolute bar to liability. Rather, the court held that the overall conduct of the Officers rebutted the "speculative inferences" of scienter sought by Plaintiffs. (A39). Again, the Ninth Circuit's holding was based on the specific facts in this case.

The Ninth Circuit's holding on scienter is entirely consistent with Supreme Court authority and the holdings of the Ninth Circuit and the other Circuits. As this Court stated in *Matsushita*:

> [To survive summary judgment], the nonmoving party must come forward with 'specific facts showing that there is a *genuine issue for trial.*' . . . Where the record taken as a whole

> could not lead a rational trier of fact to find for the non-moving party, there is no 'genuine issue for trial.' . . . It follows from these settled principles that if the factual context renders [the non-movants'] claim implausible – if the claim is one that simply makes no economic sense – [the non-movants] must come forward with more persuasive evidence to support their claim than would otherwise be necessary.

475 U.S. at 587 (citations omitted). Thus, where, as here, speculative inferences based on circumstantial evidence of wrongdoing are contradicted by defendants' overall pattern of conduct, summary judgment is appropriate. *See id.* at 596-97 (where defendants have no motive to engage in wrongdoing and their "conduct is consistent with other equally plausible explanations, the conduct does not give rise to an inference of [wrongdoing]"); *Apple*, 886 F.2d at 1117 (same).

C. The Ninth Circuit Applied The Correct Summary Judgment Standards.

Plaintiffs' argument that the Ninth Circuit applied controlling summary judgment standards improperly to the facts of the case is not appropriate for review by this Court. Indeed, Plaintiffs do not even muster an argument that this Court's review of this issue will affect parties other than those involved in this case. The Ninth Circuit established no new law in this area, relying on well-settled summary judgment principles set forth by the Ninth Circuit in *Hanon v. Dataproducts Corp.*, 976 F.2d 497, 500 (9th Cir. 1992), which were based on this Court's decisions in *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242,

247-48 (1986) and *Matsushita Electric Industry Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986).

Plaintiffs misapprehend controlling authority by asserting that the Ninth Circuit "disregarded" the controlling principles set out in those cases. *See* Pet. at 29 (court found the Class' evidence "not very probative"). Supreme Court and Ninth Circuit precedent *require* that summary judgment be granted when plaintiffs fail to provide "significant probative evidence" to allow a reasonable jury to find in their favor.[7] Thus, the Ninth Circuit was obligated to analyze the evidence to determine whether it was probative of Plaintiffs' allegations.

What Plaintiffs are really asserting is that the panel should have indulged their speculative inferences based on circumstantial evidence. This Court has emphasized, however, that summary judgment may not be defeated by such inferences.[8] In short, the Ninth Circuit applied the appropriate standards for summary judgment.

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[7] *See Anderson*, 477 U.S. at 252-54; *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1113 (9th Cir. 1989), *cert. denied*, 496 U.S. 943 (1990); *Smolen v. Deloitte, Haskens & Sells*, 921 F.2d 959, 963 (9th Cir. 1990).

[8] *Matsushita*, 475 U.S. at 587; *see also Hanon*, 976 F.2d at 500; *In re Coordinated Pretrial Proceedings in Petroleum Prods. Antitrust Litig.*, 906 F.2d 432, 441 (9th Cir. 1990), *cert. denied*, 500 U.S. 959 (1991).

IV. CONCLUSION

For the foregoing reasons, the Officer Respondents respectfully request that the Court deny Plaintiffs' Petition for a Writ of Certiorari.

Respectfully submitted,

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